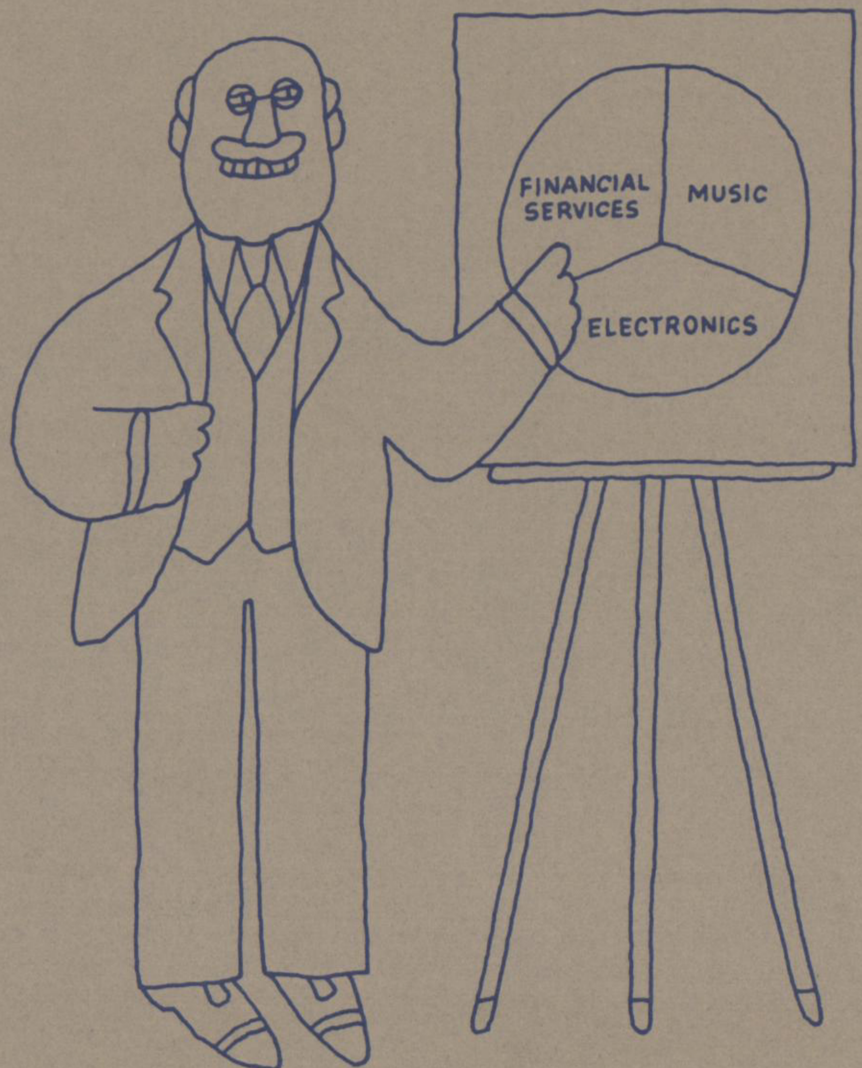
D.H. Baldwin Company Annual Report 1969

For The 107th Year Ending December 31, 1969



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Financial Highlights

D. H. Baldwin Company and Subsidiaries

	1969	1968*	% of Change
Net sales	$56,141,903	$61,441,654	(8.6)
Net income for year	4,494,479	3,742,120	20.1
Per common share	3.86	3.26	18.4
Dividends paid on common stock	1,396,985	1,378,400	1.3
Per common share	1.20	1.20	—

*Adjusted for restatement of 1968 net income as explained in note 1 of notes to consolidated financial statements.

Letter To Shareholders

There seems to be a tendency these days to turn annual reports either into picture books or humorless notes to the financial statements. We have chosen instead to serve up the figures with a smile — our way of saying that Baldwin has had a very good year, all things considered.

December 31, 1969, marked not only the end of our One-Hundred-and-Seventh year in business, but also the end of a decade of major changes for our Company. The year ended with three highlights: (1) the highest earnings in the Company's history, $4,494,000; (2) infusion of major capital into Baldwin's financial structure through the merger with Bowfund Corporation; (3) accelerated emphasis on developing high technology business.

Last year, I pointed out to you the close relationship between the three parts of our Company's activities — music, electronics, and financial services, each converging on the other. This year we are reporting the financial results of these activities separately, in line with developing corporate practice. This I feel gives our shareholders a better insight into our financial results. I must warn, however, that extension of this concept of three separate entities would be misleading. This company is a unitary one so that the profitability of one branch of activity should not be considered entirely separate from the other.

The past decade, as shown in our Ten Year Comparative Statement, has witnessed an approximate doubling of our sales and tripling of our earnings. The value of the assets of the Company has risen from $29,000,000 to $549,000,000; and the average market value of our shares on an adjusted basis has risen from $9.50 to $42.00. The prices of our merchandise have also risen during the past decade, but not nearly enough to match the average consumer price increase of 28%.

The merger with Bowfund Corporation completed on December 31, 1969, brings a substantial addition to our capital structure. In our opinion this merger was a most effective way to bring needed additional capital into the Company, while protecting the interests of our shareholders.

Credit restrictions imposed by the United States Government and resulting high interest rates had a substantial effect on Company operations during 1969. They limited our growth, affected the financing and sales of pianos and organs adversely, reduced the lending potential of The Central Bank and Trust Company and Empire Savings, Building and Loan Association, and substantially increased our operating expenses through the increased cost of borrowed money.

Your Company joined with other manufacturers in the National Piano Manufacturers Association under the leadership of Mr. Morley P. Thompson, Vice President of your Company, to initiate positive action to meet overseas competition in musical instruments. This Association effected the first successful petition for relief under the Trade Expansion Act of 1962. The Tariff Commission found that there was a real threat of injury to the American piano industry and recommended relief for the industry. President Nixon has raised the duty on pianos from the 8.5% level of duty scheduled for 1971, to 13.5% on certain models of imported pianos.

The year 1970 presents strong challenges to the management of your Company. There is a continuing squeeze on profit margins in our established music consumer business, aggravated by slack demand in the industry. Teaching systems such as the Baldwin Electropiano Laboratory offer an answer and an entry into the field of education which we are actively promoting. In order to continue our growth in financial service, we must seek avenues for funds other than those provided by our existing sources. There is a great opportunity for growth in Baldwin Electronics, Inc., where business in new technologies should produce future sales and earnings increases.

In January of this year the President of the United States announced the creation of a commission to study financial institutions to recommend "needed changes in our financial institutions and regulatory structure". Pending this commission report, further action on one-bank holding company legislation affecting Baldwin seems in doubt. Any positive steps to be taken by Baldwin will be reported to you forthwith.

Respectfully,

Lucien Wulsin

President

March 17, 1970

Sales: For the first time since 1961, the Company's sales declined. Net sales in 1969 amounted to $56,142,000 compared to $61,442,000 in 1968, a decline of 8.6%. In the category of keyboard musical instruments, sales decreased from $45,798,000 to $45,587,000 or .5%. Sales of non-keyboard musical instruments declined 23.5%.

In our electronics business, sales declined from $10,316,000 to $6,479,000. This decline of 37.2% arises in large measure from a reduction in volume of certain engineering and production contracts with the United States Government. In reporting the sales of electronic items, we did not include our proportionate sales of Siliconix incorporated, our affiliate; nor did we include in our net sales gross receipts from our finance department, from The Central Bank and Trust Company, or from The Empire Savings, Building and Loan Association.

Earnings: In reporting earnings of $4,494,000 compared with $3,742,000 in 1968, we have continued the accounting practice of prior years and in particular those adopted in 1968 dealing with the reported earnings of The Central Bank and Trust Company.

The recent change for reporting bank earnings has not affected Baldwin's reporting of Central Bank earnings since these practices were already in effect for prior years. As reported to you last year, the earnings of Central Bank, Empire and Siliconix incorporated are shown in the Consolidated Statement of Income and Earnings Reinvested in the Business of D. H. Baldwin Company under the caption "Equity Increase in Unconsolidated Subsidiaries". Our earnings in the musical instrument business declined in 1969 over 1968 by 36.3%. Our percentage of profit on sales also declined. In our electronics business our earnings declined compared to our earnings in 1968 by 53%; our percentage of profits on revenue in 1969 was 8.6% as compared with 11.5% in 1968, a change of 2.9%. In our financial services, our earnings increased from $1,647,000 in 1968 to $3,364,000 in 1969, an increase of 104.2%.

It is clear that the major increase in our earnings in 1969 came from our ownership of Central Bank and Empire. As reported to you during the year, the Company acquired Jefferson Savings and Loan Association in Denver. This acquisition increased earnings during the fourth quarter of the year by $116,000. Baldwin continued its joint venture agreement with Electronic Engineering Company under which Baldwin reports its pro rata share of Siliconix earnings. The Company's share of equity increase in Siliconix for 1969 amounted to $200,000.

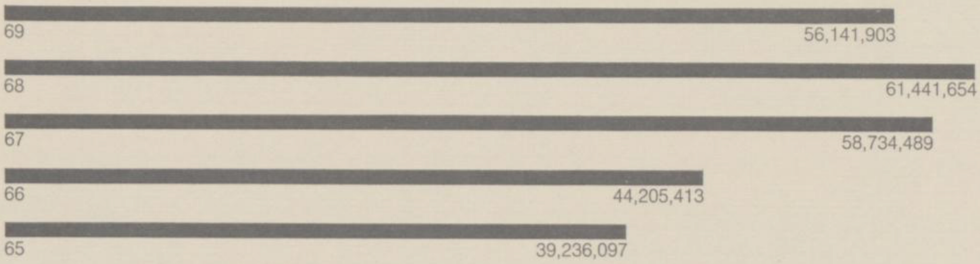
Balance Sheet: In our Balance Sheet as of December 31, 1969, with comparative 1968 figures, we have only shown the net effect after taxes, and interest of our equities in Central Bank, Empire and Siliconix. There is no attempt to consolidate all assets and all liabilities of the parent and all of its subsidiaries and affiliates. In this regard, reference should be made to Notes to Consolidated Financial Statements and The Accounting and Financial Practices.

With respect to D. H. Baldwin Company and Consolidated Subsidiaries, total current assets on December 31, 1969, amounted to $79,357,000; total current liabilities $40,653,000, a ratio of 1.95 to 1.00. During the year, the total capital increased from $28,048,000 to $45,706,000. This results in a book value as of December 31, 1969, of $26.83 per common share. Earnings of $3,097,000 were reinvested in the business.

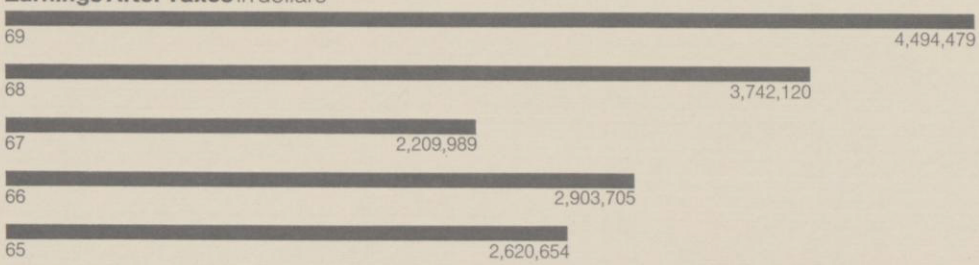
During the year, the Company made arrangements to convert $20,000,000 of short-term indebtedness into seven year long-term debt. The Eurodollar market was the source of this long-term financing. As a result of the reinvestment of earnings and our Bowfund merger, the permanent capital in our business increased from $28,048,000 in 1968 to $45,706,000 in 1969.

Dividends: During the year, the Company maintained its quarterly dividend of $.30 per common share.

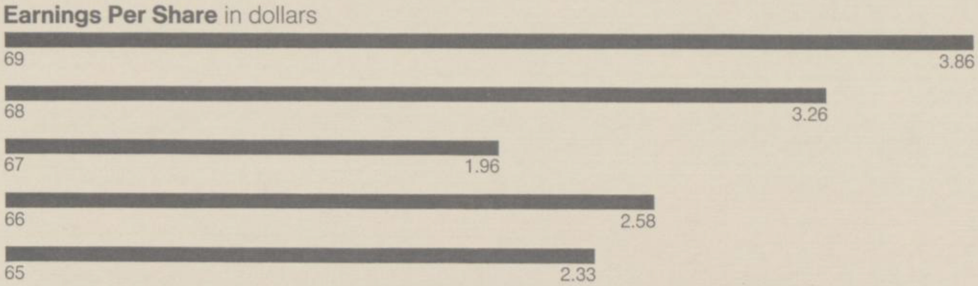
Net Sales in dollars



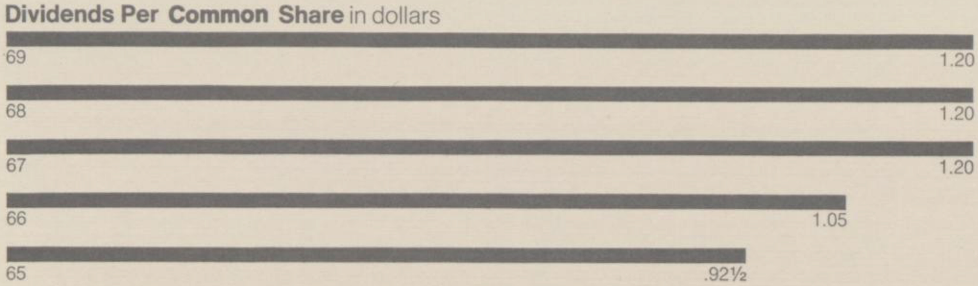
Earnings After Taxes in dollars



Earnings Per Share in dollars



Dividends Per Common Share in dollars



Ten Year Comparative Statement

D. H. Baldwin Company and Subsidiaries

In thousands of dollars	1969
Total Assets	$549,408
Net Sales — Musical Instruments	49,663
Net Sales — Electronics	6,479
Net Sales — Total	56,142
Net income for year	4,494
Per common share**	3.86
Cash dividends paid on common stock	1,396
Per common share**	1.20
Annual earnings reinvested in the business	3,097
Stockholders' Equity	45,706
Book value per common share**	26.83

*Includes the sale, on December 31, 1967, of inventory to the D. H. Baldwin Trust, amounting to $8,703,001.

**Adjusted for stock dividends and splits, expressed in dollars.

***Adjusted for restatement of 1968 net income as explained in note 1 of notes to consolidated financial statements.

1968	1967	1966	1965	1964	1963	1962	1961	1960
$474,287	$67,157	$59,975	$47,997	$43,406	$35,830	$34,223	$30,126	$28,925
51,126	53,376*	41,498	36,746	33,702	32,066	32,758	31,645	31,427
10,316	5,358	2,707	2,490	2,565	1,904	1,028	1,669	2,256
61,442	58,734	44,205	39,236	36,267	33,970	33,786	33,314	33,683
3,742***	2,210	2,904	2,621	2,087	1,343	1,241	1,004	1,511
3.26***	1.96	2.58	2.33	1.88	1.21	1.12	.90	1.36
1,378	1,356	1,181	1,032	606	551	482	413	413
1.20	1.20	1.05	.92½	.55	.50	.43¾	.37½	.37½
2,346***	823	1,713	1,579	1,471	783	749	580	1,089
28,048***	25,085	24,007	22,416	20,659	19,188	18,405	17,656	17,076
24.17***	22.02	21.29	19.90	18.59	17.26	16.55	15.87	15.35

Late in 1969, Baldwin established an Electropiano Teaching Laboratory in Carnegie Hall. The choice of that famous music center is significant. It proclaims that the Electropiano Laboratory teaching concept has come of age. Group teaching—and group learning—are "in".

At the end of 1969, Electropianos were on back-order, a situation soon to be improved by new production arrangements. A traveling Electropiano Laboratory has been particularly successful in introducing this teaching concept to teachers and students. Housed in a trailer, the three-instrument laboratory is driven to school and college campuses, and other locations which have good sales potential. The buffeting these instruments take in their travels has been a strong sales point for the dependability of their electronic circuitry; and teachers are especially taken with their true piano action and sound.

Keyboard units sold by Baldwin and the industry have remained virtually constant for five years, while profitability has dropped. The result has been a steady decline in earnings on keyboard instruments, even though Baldwin has maintained its share of the market.

There are numerous reasons why pianos and organs have not shared well in the galloping materialism of the last few years — competition for leisure time dollars, new "glamour" products, high prices. Perhaps the most telling reason is the learning cycle — the time and discipline required before the pleasures of keyboard instruments can fully be enjoyed. Now, with sociable, speedy and effective group instruction available through growing numbers of Baldwin dealers and independent studios, keyboard instrument sales have a strong foundation for future improvement.

During 1969 new models of home and church organs achieved encouraging sales.

Throughout our keyboard lines tighter inventory controls from raw materials to market have been put into effect, and prices are being adjusted upward. Both should help to turn the profit trend around.

A minor part of the falloff in musical instrument profits can be ascribed to our subsidiary, the Fred Gretsch Co., which experienced a 12% drop in sales. Gretsch manufactures and markets stringed and band instruments. A three month's strike during the last quarter of the year cost Gretsch 7½ % in sales alone, but there were other factors associated with the shifting nature of popular music and general unrest.

Two years ago, every kid on the block wanted to belong to a "combo" or "group" and play his own electronically-amplified instrument. Today this amateur business has declined, although professional sales continue strong.

Tightening school budgets have curtailed many activities once considered a necessary adjunct to secondary school education, including school bands. This has had an adverse effect on Gretsch instrument sales. An encouraging note is that hard rock and country music appear to be drawing closer together. Gretsch flat-top guitars and Sho-Bud steel guitars are particularly suited to the instrumentation of the new country-rock bands.

A long time ago we just made pianos.

Baldwin Electronics is healthy in spite of heavy government commitments, and is moving steadily toward greater involvement in industrial growth markets.

About 70% of Baldwin Electronics sales are in government business, principally rocket motors, timers, fuzing devices for ordnance, and optical tracking and encoder equipment for the Space Program. Eventually, some $5,000,000 of this will have to be replaced by other business. Government business is still coming in. The current slowdown in orders reflects lack of funding more than outright elimination of government programs.

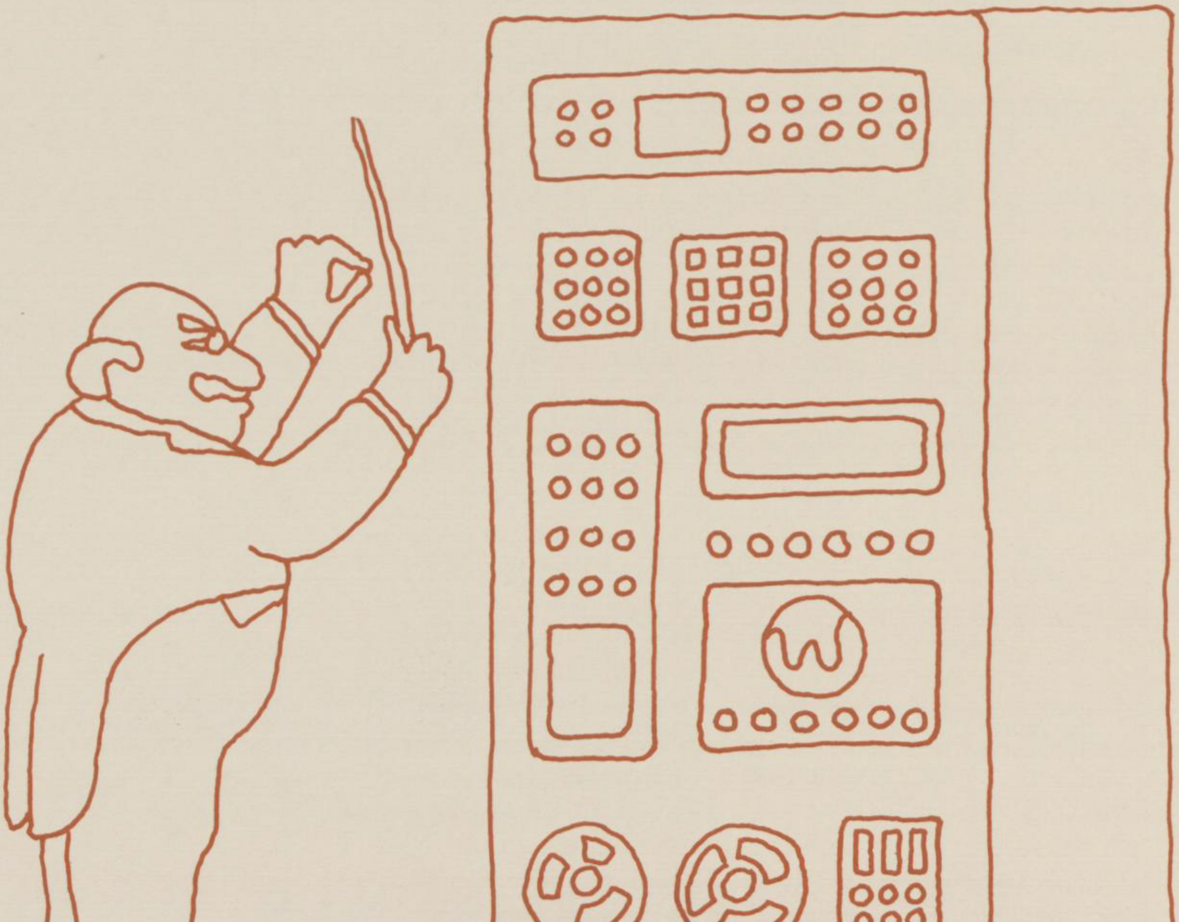
New electronics business is being developed in three principal areas: (1) Electronic components for products of other divisions of the Company — the Electropiano Laboratory, electronic organs, and an automotive safety device. (2) Industrial (OEM) products arising naturally out of Baldwin's background in electronic musical instrument development and production. (3) New and lower-cost military items, in particular an electrical time fuze that requires no battery, contains no clockwork, and can be used with a laser range finder.

Quantrol Electronics,Inc.,the El Paso, Texas subsidiary formed only a year ago to manufacture photo-cells under exclusive license from NCR, should be in the black before the end of 1970. Quantrol photo-cells are being used in machine controls, street lights, and safety devices.

A recent development of great potential to Quantrol Electronics, Inc. is a photo-cell array, a network of cells formed together on a single substrate, and planned for use in credit card readers. During the next year these arrays will begin appearing in computer "peripherals", the area of greatest growth in the computer market.

Siliconix, a Sunnyvale, California affiliate formed in 1962, and 29.3% owned by Baldwin has continued to grow encouragingly. 1969 sales were up 30% over 1968. This highly specialized producer of hybrid integrated circuits is still a small company in the big world of electronics, but it has prepared carefully for growth by developing solid management and marketing teams to move Siliconix technology ahead in the marketplace.

Newest of the Baldwin Electronics family is Electron Emission Systems, of Tucson, Arizona. This wholly-owned subsidiary was formed in 1969 in conjunction with scientists from Stanford Research Institute (who refer to it familiarly as "E^2S"). E^2S makes new electronic devices called "integrated vacuum circuits" (IVC), which in effect reduce the vacuum tube to subminiature size. Their great potential appears to lie in their ability to operate under conditions of heat and radiation that defeat familiar semiconductors. Demand is increasing rapidly for such products in supersonic aircraft, missiles, space communications systems, and deep oil well drilling. Another use is as a multiplexer to cram more electrical information through coaxial cables.



Baldwin makes more than just music.

It was logical enough for Baldwin to enter into Financial Services through its own musical instrument financing operations. However, the heavy concentration of the Company's growing financial business in the Denver area surely raises the question, "Why Denver?"

Perhaps the simplest answer is, "That's where the sound growth is." The Denver, Colorado, area is one of the fastest growing in the country. In 1968 your Company acquired The Central Bank and Trust Company, the largest state bank in Colorado, and the fourth largest in Denver. Central Bank has the largest installment loan department in the 10th Federal Reserve District, and the 28th largest mortgage servicing operation in the United States. The net operating income of this bank has doubled since 1967.

In November, 1968, Baldwin acquired Empire Savings, Building and Loan Association, also of Denver. It is the fourth largest saving and loan association in the Rocky Mountain region, with assets of $167,000,000. This association has never had "scheduled" (past-due) items exceeding 1/10 of 1% of loans outstanding. Baldwin recently purchased Jefferson Savings and Loan Association, of Denver, with assets of $18,000,000, adding two more offices to the nine operated by Empire.

Both Central Bank and Trust and Empire Savings are owned by Baldwin Central, Inc., a holding company and wholly-owned subsidiary of D. H. Baldwin.

Musical instrument installment financing handled by your Company continued to show steady growth, up 6.9% from 1968. Losses were negligible. Lease-purchase arrangements were encouraged as an additional tool to help Baldwin dealers sell pianos and organs, especially to schools.

On January 1, 1970, Baldwin entered into an agreement to lend $14,750,000 to the National Farmers Union Service Corporation, a holding company for three Best-rated insurance companies serving rural America with premium income of $26,000,000 from life, casualty, health, and special risk insurance. This unusual opportunity to lend to, instead of borrow from, an insurance company carries with it equity participation. Although it is too early to tell the effect on 1970 earnings, if this investment had been made early in 1969, the net effect on Baldwin profits would have been over 60 cents a share improvement.

D. H. Baldwin Company and Subsidiaries
Consolidated Balance Sheet
December 31, 1969 with comparative figures for 1968

Assets	1969	1968
Current Assets:		
Cash	$ 4,210,962	$ 3,330,115
Marketable securities, at cost which approximates market value (note 1)	9,032,723	—
Receivables, less allowance for possible losses, $964,152 ($855,717 in 1968) (note 2)	44,931,163	32,874,472
Inventories (note 3):		
Finished goods	7,789,422	8,011,251
Work in process	5,642,271	5,005,834
Raw materials	6,373,518	4,913,488
Total inventories	19,805,211	17,930,573
Prepaid expenses	1,377,288	924,989
Total current assets	79,357,347	55,060,149
Investments, Advances and Other Assets (note 1)	17,849,617	13,793,186
Property, Plant and Equipment, at cost (note 4):		
Land	518,638	334,193
Buildings	4,806,039	4,191,993
Machinery and equipment	5,955,828	5,681,956
Leasehold improvements	985,195	910,251
	12,265,700	11,118,393
Less accumulated depreciation	6,922,375	6,439,012
Net property, plant and equipment	5,343,325	4,679,381
Intangibles, at cost less amortization	427,553	693,684
	$102,977,842	$74,226,400

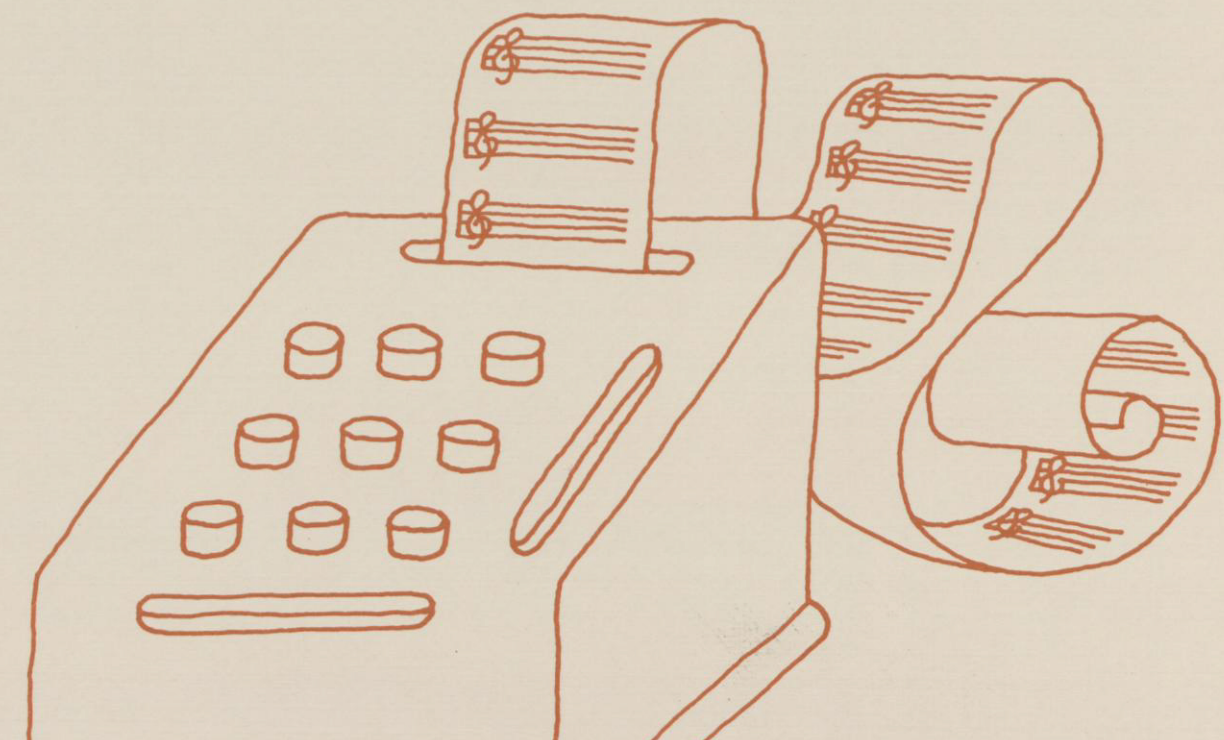
See accompanying notes to consolidated financial statements.

Liabilities and Stockholders' Equity	1969	1968
Current Liabilities:		
Notes payable	$ 30,293,304	$25,271,022
Long-term debt, current portion	900,000	400,000
Accounts payable	1,488,841	1,994,467
Accrued liabilities	2,727,886	3,008,121
Dealers' commissions	1,428,693	1,350,962
Taxes on income (note 5)	3,814,092	6,696,126
Total current liabilities	40,652,816	38,720,698
Long-Term Debt, less current portion (note 6)	14,500,000	5,400,000
Other Non-Current Liabilities	2,119,318	2,058,000
Stockholders' Equity (notes 1, 5, 6 and 7):		
Capital stock:		
Series A 5% cumulative convertible preferred, par value $108 per share.		
Authorized 76,046.5 shares; issued 68,301 shares	7,376,511	—
Series B 8% cumulative preferred, par value $100 per share.		
Authorized 144,138 shares; issued 70,372 shares	7,037,211	—
Common, without par value. Authorized 4,000,000 shares;		
issued 1,168,851 shares at stated value (1,161,852 in 1968)	4,675,404	4,647,408
Earnings capitalized and other additions to capital	1,318,395	1,168,608
Earnings reinvested in the business	25,391,965	22,294,471
	45,799,486	28,110,487
Less cost of 2,386 common shares in treasury (1,840 in 1968)	93,778	62,785
Net stockholders' equity	45,705,708	28,047,702
	$102,977,842	$74,226,400

D. H. Baldwin Company and Subsidiaries
Consolidated Statement of Income and Earnings Reinvested in the Business
Year ended December 31, 1969 with comparative figures for 1968

	1969	1968 (note 1)
Music		
Net sales	$49,663,299	$51,125,753
Other revenues	939,672	880,036
	50,602,971	52,005,789
Expenses:		
Cost of products sold	36,240,877	37,191,588
Selling and administrative	11,979,250	12,259,533
Interest	1,235,558	1,060,309
Federal income taxes	589,000	618,000
	50,044,685	51,129,430
Music Net Income	558,286	876,359
Financial Services		
Income from installment receivables	3,539,586	2,847,080
Equity increase in unconsolidated subsidiaries (note 1)	3,207,190	1,130,480
	6,746,776	3,977,560
Expenses:		
Interest	1,904,237	1,023,494
Operating expenses	1,394,584	1,039,051
Federal income taxes	84,000	268,000
	3,382,821	2,330,545
Financial Services Net Income	3,363,955	1,647,015
Electronics		
Net sales	6,478,604	10,315,901
Equity increase in Siliconix incorporated-joint venture (note 1)	200,052	245,416
	6,678,656	10,561,317
Expenses:		
Cost of products sold	4,541,378	7,585,570
Selling and administrative	1,151,616	908,805
Interest	249,424	204,196
Federal income taxes	164,000	644,000
	6,106,418	9,342,571
Electronics Net Income	572,238	1,218,746
Net Income For Year	4,494,479	3,742,120
Earnings reinvested in business at beginning of year	22,294,471	19,948,779
	26,788,950	23,690,899
Deduct:		
Cash dividends:		
Preferred stock — $6.00 per share	—	685
Common stock — $1.20 per share	1,396,985	1,378,400
Redemption of preferred stock	—	17,343
	1,396,985	1,396,428
Earnings Reinvested in Business at End of Year	$25,391,965	$22,294,471
Net Income Per Share of Common Stock (note 7)	$3.86	$3.26

See accompanying notes to consolidated financial statements.



exercisable. Stock options exercised during the year and outstanding at the end of the year are as follows:

	Shares	Option price per share
Options exercised	4,150	$10.12 - 10.75
Options outstanding	27,200	$31.75 - 34.00

Changes in earnings capitalized and other additions to capital in 1969 are as follows:

Balance at beginning of year	$1,168,608
Excess of the sales price of unissued common stock over the stated value:	
Stock option plan	27,919
Employees stock purchase plan	119,383
Gain on sale of common stock held in treasury	2,485
Balance at end of year	$1,318,395

At December 31, 1969, 152,093 shares of common stock were reserved for conversion of the Series A convertible preferred stock.

Net income per share of common stock has been computed based on the weighted average number of shares outstanding during the year. The dilutive effect in 1969 on net income per share of common stock which would result assuming issuance of common stock reserved for sale or option and conversion of all outstanding Series A 5% preferred stock into common stock is immaterial.

In 1969, the Company eliminated all previously authorized preferred stock.

8. Pension plan: The Company maintains pension plans for certain union employees and all other eligible employees. The Company accrues and funds all actuarially determined costs, including amortization of past service costs generally over a twenty-five year period. Pension expense for the year amounted to $454,000 ($447,000 in 1968) before a deduction for Federal income taxes. There are no unfunded vested benefits.

9. Contingent liabilities and commitments: In January, 1970, Baldwin-Central agreed to purchase a $14,750,000 convertible bond due in 1992 from National Farmers Union Service Corporation, an insurance holding company, in exchange for $1,146,000 cash and a $13,604,000 promissory note due in quarterly installments in varying amounts until 1992. At any time after issuance and prior to final payment of the bond, Baldwin-Central may convert the bond into 90% of the outstanding common stock of National Farmers Union Service Corporation. In addition, the bond may be exchanged for convertible, participating, cumulative preferred stock with an aggregate par value of $14,750,000.

At December 31, 1969, total minimum annual rentals (exclusive of amounts based on sales) payable under leases, expiring on various dates to 1985, and the rent expense for 1969 amounted to approximately $767,000 and $905,000, respectively, before a deduction for Federal income taxes.

Accountants' Report

The Board of Directors and Stockholders
D. H. Baldwin Company:

We have examined the consolidated balance sheet of D. H. Baldwin Company and subsidiaries as of December 31, 1969, and the related statement of income and earnings reinvested in the business for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and consolidated statement of income and earnings reinvested in the business present fairly the financial position of D. H. Baldwin Company and subsidiaries at December 31, 1969, and the results of their operations (by group) for the year then ended, in conformity with generally accepted accounting principles, applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Cincinnati, Ohio
February 27, 1970

D. H. Baldwin Company and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 1969

1. Principles of consolidation: The consolidated financial statements include the accounts of the Company and all of its subsidiaries since dates of acquisition or organization, except with respect to Baldwin-Central, Inc. (a holding company) and a real estate company. The investments in unconsolidated subsidiaries are carried at cost ($11,016,000) plus the Company's portion of changes in their net assets since dates of organization ($4,560,000).

In June, 1969, Baldwin-Central completed studies to make an appropriate allocation as of the dates of acquisition of the amounts paid for the stock of The Central Bank and Trust Company and The Empire Savings, Building and Loan Association, both of Denver, Colorado, to tangible and intangible assets. The effect of retroactively applying the allocation to dates of acquisition to previously reported figures for the year ended December 31, 1968, is as follows:

	As previously reported	As restated
Equity increase in unconsolidated subsidiaries	$1,118,116	$1,417,263
Net income	$3,442,973	$3,742,120
Net income per share of common stock	$3.00	$3.26

Effective December 31, 1969, the Company issued 138,673 shares of newly authorized preferred stock consisting of 68,301 shares of Series A 5% cumulative convertible stock, par value $108, and 70,372 shares of Series B 8% cumulative stock, par value $100, in a statutory merger with Bowfund Corporation, a management investment company of Chicago, Illinois. The Company intends to convert into cash the assets acquired, principally marketable securities, and apply the proceeds to reduce borrowings.

Baldwin-Central has pledged the capital stock of Central Bank and Empire and 464,494 shares of Siliconix incorporated capital stock (owned by a joint venture of Baldwin-Central) as security for notes payable issued in connection with the purchase of Central Bank and Empire capital stock.

For 1969, operations have been reported on a "product line" basis. General office expenses, occupancy costs and interest expense incurred by the Company have been allocated to the product lines. In addition, direct expenses have been charged to the respective product lines. Operations for 1968 have been restated to conform with the 1969 presentation.

2. Installment receivables: Installment accounts, in most cases, extend over a period of three years. It is not practicable to determine the amount of installment receivables not due within one year. Carrying charges are taken into income as received.

3. Inventories: In accordance with the Company's consistent policy, inventories are stated at the lower of cost (first-in, first-out) or market (replacement) with the exception that the valuation of certain work in process includes no manufacturing overhead costs. The omission of this overhead had no material effect upon net income.

4. Policy as to depreciation: On a majority of property, plant and equipment acquired new, the Company's policy is to provide for depreciation according to the sum-of-the-years-digits method. For all other items the straight-line method is used. Depreciation before a deduction for Federal income taxes aggregated $751,980 in 1969 and $787,183 in 1968.

5. Taxes on income: Deferred income taxes of $3,750,000 ($5,850,000 in 1968) arising principally from installment sales have been included in current liabilities. The provision for Federal income taxes includes approximately $806,000 ($28,000 in 1968) due to the recognition of deferred income taxes in accordance with Accounting Principles Board Opinion #11 and a reduction of $154,000 ($500,000 in 1968) due to the tax benefit derived from filing a consolidated Federal income tax return.

Included in the Company's earnings reinvested in the business at December 31, 1969 is $741,750 appropriated for general reserves by Empire since its acquisition which represent bad debt deductions for which no Federal income tax has been provided. If, in the future, these reserves are charged for any purpose other than to absorb bad debt losses, a tax liability will be imposed at the then current Federal income tax rates.

6. Long-term debt consists of the following:

5% note, payable $900,000 annually through 1975	$5,400,000
8⅜% note, payable $1,000,000 annually 1973 through 1975, final payment of $2,000,000 due June, 1976	5,000,000
Notes payable bearing a variable interest rate of 1% above the average interest rates at which the participating banks' London offices are able to acquire United States dollars. Semi-annual payments of $1,000,000 are required beginning June 30, 1972, with final payment due on June 30, 1974	5,000,000
	15,400,000
Less current portion	900,000
	$14,500,000

The 5% note agreement contains certain restrictions relating to the payment of cash dividends on common stock, as well as to the purchase, redemption or retirement of the Company's capital stock, and provides, among other things, that the Company maintain working capital (as defined) of at least $18,000,000. At December 31, 1969, approximately $4,691,000 of the earnings reinvested in the business was free of these restrictions.

In February, 1970, the Company completed arrangements for $10,000,000 in additional long-term borrowings.

7. Capital stock and earnings capitalized and other additions to capital: Of the unissued common stock, 51,493 shares are reserved for sale to the Company's employees, for the granting of options under the stock option plans and, in part, for sale to the trustee of the Company's profit sharing plan. Under the stock option plans, options may be granted to certain employees to purchase common stock of the Company at a price not less than the market value on the date of granting. All outstanding options at December 31, 1969, were

Baldwin-Central, Inc.

(A wholly-owned subsidiary of D. H. Baldwin Company)

Balance Sheet

December 31, 1969 with comparative figures for 1968

	1969	1968
Assets		
Cash	$ 70,945	$ 32,128
Investments (notes 1, 2, 3 and 5):		
Capital stock of subsidiaries	34,689,618	28,679,323
Contract to acquire a savings and loan association	1,816,288	—
Joint venture	1,336,577	1,134,117
Subordinated capital debenture of subsidiary bank	3,000,000	3,000,000
Total investments	40,842,483	32,813,440
Other assets	68,601	7,465
	$40,982,029	$32,853,033
Liabilities and Stockholder's Equity		
Accounts payable and accrued expenses	$ 254,273	$ 148,901
Amount payable in connection with acquisition of a savings and loan association (note 2)	1,700,000	8,652,270
Notes payable to banks (note 3)	22,000,000	12,000,000
Amount due parent company	1,616,597	99,617
Total liabilities	25,570,870	20,900,788
Stockholder's Equity (notes 3 and 6):		
Common stock, without par value. Authorized 5,000 shares; issued 3,578 shares at stated value	10,734,000	10,734,000
Earnings reinvested in the business	4,677,159	1,218,245
Total stockholder's equity	15,411,159	11,952,245
	$40,982,029	$32,853,033

See accompanying notes to financial statements.

Statement of Income and Earnings Reinvested in the Business

Year ended December 31, 1969 with figures for the seven months ended December 31, 1968

	1969	1968 (note 1)
Equity Increase in Investments (notes 1 and 2)	$4,530,075	$1,461,464
Expenses		
Interest	2,248,345	516,183
Other	9,816	36
	2,258,161	516,219
Net Income Before Federal Income Tax Credit	2,271,914	945,245
Federal income tax credit (note 4)	1,187,000	273,000
Net Income For Period	3,458,914	1,218,245
Earnings Reinvested at Beginning of Period	1,218,245	—
Earnings Reinvested at End of Period	$4,677,159	$1,218,245

See accompanying notes to financial statements.

Baldwin-Central, Inc.

(A wholly-owned subsidiary of D. H. Baldwin Company)

Notes to Financial Statements

December 31, 1969

1. Investments: In June, 1968, the Company acquired 99% of the capital stock of The Central Bank and Trust Company, for $18,381,688. In November, 1968, the Company acquired 84% of the capital stock of The Empire Savings, Building and Loan Association for $8,836,171 and in 1969 acquired an additional 15% for $1,651,922.

The Company's portion of the equity increase in investments since the dates of acquisition has been included in the Company's income statement. Based on studies completed during 1969, the Company has made an appropriate allocation as of the dates of acquisition of the amounts paid for the stock of Central Bank and Empire to tangible and intangible assets. Adjustments, applied retroactively to dates of acquisition, to the subsidiaries' net earnings to give effect for this allocation are as follows:

	Year ended Dec. 31, 1969	7 months ended Dec. 31, 1968
Equity increase before minority interest	$3,384,000	$1,200,129
Less minority interest	11,798	37,812
	3,372,202	1,162,317
Add (deduct) adjustments arising from allocation of purchase price:		
Discount earned on loans and investment securities	1,327,064	308,333
Depreciation	74,161	10,427
Amortization of premium on mortgages payable and debentures	(35,307)	(19,613)
Gain on sale of land	(208,045)	—
	1,157,873	299,147
Equity increase applicable to company	$4,530,075	$1,461,464

The effect of retroactively applying the allocation of purchase price to the dates of acquisition is an increase in net income of the Company from $919,098 as previously reported for the period ended December 31, 1968, to $1,218,245, an increase of $299,147.

The Company's costs exceeded its share of the fair value of investments at acquisition by $15,960,000. The amount is not being amortized as management believes its value has not diminished.

2. Investment in contract: Effective September 1, 1969, the Company entered into a contract to acquire Jefferson Savings and Loan Association of Denver, Colorado, for $1,700,000 in cash, which transaction will close in the future. The only conditions for closing are the approvals of certain regulatory authorities and the obtaining of a favorable income tax ruling. The investment is carried at cost plus earnings of Jefferson since the effective date of the contract.

3. Notes payable to banks: Notes payable to banks consist of $12,000,000 due July 1, 1970, and $10,000,000 due January 31, 1971, each bearing interest at ½ of 1% over the prime interest rate. The loan due in 1970 is secured by all of the capital stock of Central Bank owned by the Company and the loan due in 1971 is secured by all of the capital stock of Empire owned by the Company and 464,494 shares of Siliconix incorporated, capital stock owned by the joint venture. Under the terms of the loan agreement the Company may not declare or pay any dividend other than those payable in capital stock of the Company, or purchase, redeem or otherwise acquire for value any of its capital stock. In addition, there are restrictions on issuance of new debt.

4. Federal income tax credit: The operations of the Company and Central Bank (since date of acquisition) were included in the 1968 consolidated income tax return filed by D. H. Baldwin Company. In 1969, Empire will also be included in Baldwin's consolidated income tax return. Federal income taxes computed on a separate return basis have been provided for Central Bank and Empire, and a tax benefit of $1,187,000 ($273,000 in 1968) which Baldwin will obtain from the Company's expenses has been allocated to the Company.

5. Subordinated capital debenture: The Company has entered into an agreement with Central Bank to pay the bank $3,000,000 on or before July 1, 1973, for the purpose of increasing the bank's capital. This obligation may be fulfilled by the Company by exchanging the subordinated non-interest bearing debenture, due 1973, in the amount of $3,000,000 presently owned by the Company for capital stock of the bank.

6. General reserves: Savings and loan associations that meet certain definitions and other conditions prescribed by the Internal Revenue Code are allowed to deduct, within limitations, appropriations for general reserves in arriving at taxable income. Included in earnings reinvested in the business of the Company is $741,750 at December 31, 1969, and $109,729 at December 31, 1968, appropriated for general reserves since acquisition which represent bad debt deductions for which no Federal income tax has been provided. If in the future these reserves are charged for any purpose other than to absorb bad debt losses, a tax liability will be imposed at the then current Federal income tax rates.

The regulations of the Federal Savings and Loan Insurance Corporation and Colorado law require Associations to maintain general reserves which may be charged for losses only. Such requirements have been met.

7. Subsequent event: In January, 1970, the Company agreed to purchase a $14,750,000 convertible bond due in 1992 from National Farmers Union Service Corporation, an insurance holding company, in exchange for $1,146,000 cash and a $13,604,000 promissory note payable in quarterly installments in varying amounts until 1992. At any time after issuance and prior to final payment of the bond, Baldwin-Central may convert the bond into 90% of the outstanding common stock of National Farmers Union Service Corporation. In addition, the bond may be exchanged for convertible, participating, cumulative preferred stock with an aggregate par value of $14,750,000.

8. Supplementary financial information: Condensed financial statements of Central Bank and Empire are on the following pages.

Accountants' Report

The Board of Directors
Baldwin-Central, Inc.
(A wholly-owned subsidiary of D. H. Baldwin Company):

We have examined the balance sheet of Baldwin-Central, Inc. (a wholly-owned subsidiary of D. H. Baldwin Company) as of December 31, 1969, and the related statement of income and earnings reinvested in the business for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of Baldwin-Central, Inc. (a wholly-owned subsidiary of D. H. Baldwin Company) at December 31, 1969, and the results of its operations for the year then ended in conformity with generally accepted accounting principles, applied on a basis consistent with that of the preceding period.

Peat, Marwick, Mitchell & Co.

Cincinnati, Ohio
February 27, 1970

The Central Bank and Trust Company and Subsidiary
Condensed Consolidated Statement of Condition

December 31, 1969 with comparative figures for 1968

	1969	1968
Assets		
Cash and due from banks	$ 61,675,783	$ 54,135,974
Investment securities, at amortized cost (market value, $29,495,358 and $32,240,000, respectively)	33,178,282	33,388,362
Federal funds sold	3,400,000	1,500,000
Loans less unearned discount of $8,876,348 ($7,614,487 at December 31, 1968)	159,192,087	150,434,794
Bank premises and equipment, at cost less depreciation of $2,933,689 and $2,632,351, respectively	3,478,729	4,610,912
Other assets	2,621,256	2,382,052
	$263,546,137	$246,452,094
Liabilities and Capital Funds		
Demand deposits	$120,842,175	$112,026,903
Time and savings deposits	88,781,380	104,589,467
Federal funds purchased	13,950,000	2,900,000
Bills payable	11,000,000	—
Other liabilities	5,446,056	5,761,727
Total liabilities	240,019,611	225,278,097
Reserve for loan losses	2,759,987	2,306,848
Capital funds:		
Subordinated capital debentures, 5¼ %	3,000,000	3,000,000
Subordinated capital debenture due Baldwin-Central, Inc.	3,000,000	3,000,000
Stockholders' equity:		
Capital stock	5,100,000	5,100,000
Surplus	5,100,000	5,100,000
Undivided profits	4,566,539	2,620,614
Reserve for securities	—	46,535
Total stockholders' equity	14,766,539	12,867,149
Total capital funds	20,766,539	18,867,149
	$263,546,137	$246,452,094

These condensed financial statements are an integral part of note 8 of notes to financial statements of Baldwin-Central, Inc.

The Central Bank and Trust Company and Subsidiary
Condensed Consolidated Statement of Income
Year ended December 31, 1969 with comparative figures for 1968

	1969	1968
Income		
Interest on loans	$13,044,840	$10,211,213
Income on investments	1,515,358	1,320,346
Other	2,152,946	1,705,320
	16,713,144	13,236,879
Expenses		
Interest	6,638,619	4,982,483
Provision for loan losses	550,742	526,888
Other operating expenses	6,386,645	5,023,246
	13,576,006	10,532,617
Income Before Income Taxes, Securities Gains (Losses), and Extraordinary Item	3,137,138	2,704,262
Federal income taxes:		
Current	643,323	885,647
Deferred	624,641	263,933
	1,267,964	1,149,580
Income Before Securities Gains (Losses)	1,869,174	1,554,682
Securities gains (losses) less related income tax effect of $1,405 and $34,214, respectively	3,007	(27,287)
Income Before Extraordinary Item	1,872,181	1,527,395
Gain on sale of land, less related income tax effect of $97,230	208,045	—
Net Income	2,080,226	1,527,395
Net income for 1968 to date of acquisition	—	517,519
Net Income After Acquisition	$ 2,080,226	$ 1,009,876

The Empire Savings, Building and Loan Association
Condensed Statement of Condition

December 31, 1969 with comparative figures for June 30, 1969

	Dec. 31, 1969	June 30, 1969
Assets		
Cash	$ 4,804,115	$ 1,562,077
U. S. Government obligations — at cost (market value, $5,801,986 and $6,154,760, respectively)	6,579,880	6,762,766
Stock in Federal Home Loan Bank of Topeka — at cost	1,959,100	1,631,300
Loans receivable	149,601,281	146,723,230
Home and branch offices, buildings and equipment,		
at cost—less depreciation and amortization of $763,230 and $718,712, respectively	2,776,708	2,631,609
Prepayment of Federal Savings and Loan Insurance	1,287,564	1,230,875
Other assets	175,572	381,016
	$167,184,220	$160,922,873

Liabilities and Stockholders' Equity		
Savings accounts	$122,232,847	$119,912,217
Loans in process	5,632,796	8,612,327
Advance payments by borrowers	5,130,683	2,696,200
Advances from Federal Home Loan Bank	23,508,250	19,380,000
Other liabilities	105,916	193,523
Total liabilities	156,610,492	150,794,267
Income deferred to future operations	976,755	956,336
Stockholders' equity:		
Permanent stock	625,000	625,000
Paid-in surplus	19,188	19,188
Undivided profits	1,044,259	777,038
Undivided profits appropriated for general reserves	7,908,526	7,751,044
Total stockholders' equity	9,596,973	9,172,270
	$167,184,220	$160,922,873

These condensed financial statements are an integral part of note 8 of notes to financial statements of Baldwin-Central, Inc.

The Empire Savings, Building and Loan Association
Condensed Statement of Operations
Year ended December 31, 1969 with comparative figures for 1968

	1969	1968
Income		
Interest on loans	$ 9,580,881	$7,739,861
Income on investments	515,771	509,451
Other	218,387	170,004
	10,315,039	8,419,316
Expenses		
Interest	7,185,663	5,842,422
Other	1,806,646	1,456,249
	8,992,309	7,298,671
Net Income Before Income Taxes	1,322,730	1,120,645
Income taxes	263,059	215,435
Net Income	1,059,671	905,210
Net income to date of acquisition	—	714,957
Net Income After Acquisition	$ 1,059,671	$ 190,253

To inform more fully our shareholders, we have briefly described below certain of the Company's Accounting and Financial Practices which affect the more significant elements of the financial statements.

Installment Accounts: The income from installment accounts receivable is taken into income on the straight line basis rather than in proportion to the size of the loan. This method used by Baldwin understates the profits of the Company during the first years of the contract. No acquisition cost is set up for these accounts and no installment income is recorded until the actual cash is received. All installment accounts receivable are taken from dealers with full recourse and a holdback. Losses in the past 25 years have averaged less than ½ of 1%.

Inventories: In accordance with the Company's consistent policy, inventories are stated at the lower of cost (first-in, first-out), or market, with the exception that the valuation of certain work in process includes no manufacturing overhead cost. Gross profit on inventories shipped on consignment to dealers amounts to approximately $3,000,000. This profit will not be recorded on the books of the Company until a check or installment contract is received from the dealer. Interest charges on consigned merchandise are not recorded until settlement is made. Charges earned but not accrued amount to approximately $700,000.

Siliconix: Siliconix stock was acquired at a cost of $900,000. At December 31, 1969, the Company's cost and equity increase recorded to date aggregated $1,300,000 as compared to a market value of $7,400,000.

Property and Depreciation: Items capitalized as part of plant and equipment represent land, buildings, equipment, and significant betterments to existing plant and equipment.

Intangible Assets: During 1969 the Company expensed $266,000 of intangible assets acquired through prior year's acquisitions.

Federal Taxes: Federal taxes payable as of December 31, 1969, amounted to $3,800,000 which for the most part are related to the gross profit margin arising from installment sales. These taxes are not due and payable until the payments are received from the customer. All taxes are accrued as current liabilities in the year of the sale regardless of the fact that they will not be paid in the foreseeable future. As long as the Company remains on the installment method under current laws with current margins, over 80% of this current liability will not have to be paid. In the unlikely event that the accounts prove to be uncollectible, this liability would not be a claim against the Company.

Research and Development: Cost in connection with research and development is expensed as incurred. It is also the Company's policy to expense new model start up costs and new model tooling costs in the year incurred.

D. H. Baldwin Company and Subsidiaries

Directors

Gordon Adamson
Vice President
Baldwin Piano & Organ Company

Max G. Brooks
Chairman of the Board
The Central Bank and Trust Company
Denver, Colorado

Fred Gretsch, Jr.
President & Director
The Fred Gretsch Company, Inc.
Brooklyn, New York

William M. Hickey
President & Director
The United Corporation
New York, New York

John F. Jordan
Vice President

Lawrence H. Kyte
Partner, Law Firm of
Kyte, Conlan, Wulsin & Vogeler
Cincinnati, Ohio

William A. Mitchell
Retired-Former Chairman of the Board
The Central Trust Company
Cincinnati, Ohio

James M. E. Mixter
Vice President

A. J. Schoenberger
Retired-Former Senior Vice President

Morley P. Thompson
Vice President

Eugene Wulsin
President
The Baldwin Piano Company
(Canada) Limited

Lucien Wulsin
President

Robert E. Fanning
Retired-Director Emeritus

Philip Wyman
Retired-Director Emeritus

Officers

Lucien Wulsin, President
John F. Jordan, Vice President
James M. E. Mixter, Vice President
Morley P. Thompson, Vice President
Eugene Wulsin, Vice President
R. F. Coghill, Secretary
R. S. Harrison, Treasurer
Timothy P. Hartman, Controller
L. H. Ellis, Assistant Secretary

General Offices

Cincinnati, Ohio

Subsidiaries

Baldwin Piano & Organ Company
The Baldwin Piano Company (Canada) Limited
Baldwin Electronics, Inc.
  Electron Emission Systems, Inc.
  Quantrol Electronics, Inc.
Baldwin Export Corporation
C. Bechstein Pianofortefabrik AG
The Baldwin Company
The Fred Gretsch Company, Inc.
Baldwin-Central, Inc.
  The Central Bank and Trust Company
  Empire Savings, Building and Loan Association

Manufacturing Plants

Arkansas: Booneville, Camden, Conway,
DeQueen, Fayetteville, Little Rock
Canada: Toronto
England: London
Mississippi: Greenwood
Ohio: Cincinnati
West Germany: West Berlin, Karlsruhe

Affiliate

Siliconix incorporated

Dealers or Company-Owned Sales Outlets

In all principal cities in the
United States, and abroad

Transfer Agents and Registrars

The Central Trust Company, Cincinnati, Ohio
Morgan Guaranty Trust Company of New York